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Contrasts in Tolerance: the Peculiar Case of Financial Regulation

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Until the eighties the system of commercial fraud investigation and prosecution was extraordinarily undeveloped. By the end of the eighties this system had been transformed. What took place was nothing short of a fundamental rethink of financial regulation and commercial fraud control. However, by the nineties this process had gone into reverse. The following discussion aims to explain why. The analysis attempts to understand the main shifts in emphasis of commercial fraud control with reference to general trends in financial regulation, the conventional politics of law-and-order and the practice of commercial fraud control itself. What seems to have happened is that commercial fraud control became temporarily drawn into, and then almost immediately detached from, the conventional politics of law and order. The discussion attempts to show how a sharp rise in the prominence of financial regulation as a political issue first coupled commercial fraud control to the major preoccupations of conventional crime policy. But, once the importance of financial regulation as a political issue faded, commercial fraud control became uncoupled from conventional law and order politics, allowing sustained criticism of long commercial fraud prosecutions in the news media to create conditions favourable for decriminalisation.

Introduction

On 14th February 1992 the jury in the Blue Arrow case returned verdicts of guilty against senior directors of some of the most prestigious financial institutions in the City of London. Blue Arrow was, on any measure, a huge and politically ambitious prosecution. In lasting just over a year the trial was the second longest on record. Its reported cost of £35 million¹ was also a record, two thousand times the cost of a typical Crown Court Proceeding in 1997-1998.² It was also one of only two fraud prosecutions to involve corporate defendants during the eighties and the only one taken against the subsidiaries of large international clearing banks. This, in conjunction with the success the defendants enjoyed in claiming that their crime was committed in the interests of their victims, rather than for their own advantage or that of their employers, gave much substance to the perception, widely held at the time,³ that the prosecution had extended the jurisdiction of the criminal law into previously uncharted areas of financial malpractice. Blue Arrow, in short, was the sort of case that seemed to leave no room to doubt the seriousness of the Government's commitment to commercial fraud control. In fact, the case was so unusual that it would have been almost inconceivable a decade earlier when cases were still being discontinued because it was thought that juries would not be able to understand them⁴ and the club atmosphere of the City meant, as the DPP put it, that 'no one ratted on his fellows'.⁵ In another sense, however, the case seemed entirely predictable - a logical culmination of a sustained, decade-long, programme of reform which had revolutionised the organisational and legal infrastructure of commercial fraud control. This process - which, among other things, had included the introduction of the Serious Fraud Office - had been designed to facilitate less expensive, more effective and, most importantly of

all, more routine prosecution. By transforming the apparatus of commercial fraud investigation and prosecution it implied that Blue Arrow had revealed the future of commercial fraud control – a future in which criminal justice would finally be lifted from the margins of financial regulation. There is, therefore, some irony in the fact that rather than announcing a new era in financial regulation, Blue Arrow in fact signalled the emergence of another, far less conspicuous, period of reform that was aimed at restoring much of the traditional order of financial regulation where criminal justice had customarily been reserved as a means of censure for those firms too small, too insolvent or simply too far removed from legitimate markets to negotiate some other, non-criminal, response.

This process of criminal justice expansionism and subsequent retrenchment represents the concerns, manifested most powerfully in the eighties but expressed consistently throughout the nineties, over the proper form that financial regulation should take. It also provides an ideal gate-of-entry into understanding the nature and impact of those reforms that transformed the system of commercial fraud control and, therefore, forms the basis of the following review of the recent history of commercial fraud detection, investigation and prosecution.

The discussion is organised around the three major periods within commercial fraud control over the last thirty years. These are the period of non-criminalisation between 1972 and 1980, a period of gradual criminalisation between 1981 and 1992 and the current period of decriminalisation which has characterised commercial fraud prosecution since 1992. One aim of the discussion is to provide a highly summarised review of the reforms, initiatives and practices that comprised these trends. The principal aim of the discussion, however, is to explain them. To this effect, the analysis attempts to understand the shifts in emphasis of commercial fraud control with reference to general trends in financial regulation, the conventional politics of law-and-order and the practice of commercial fraud control itself. Although this process at once underlies and was made possible by a parallel process of ‘modernisation’, it was not reducible to it. In fact, in many respects it seems misleading, or at the very least incomplete, to attribute what happened to a drive to make more efficient, to increase the professionalism of or to achieve value for money from the system of commercial fraud control. This is because the term implies a process devoid of the question of politics or which is unrelated to the Government’s attempts to reposition the British economy in the eighties – both of which are fundamental to understanding the development of commercial fraud control. What emerges from the following discussion is a relatively simple tale of how commercial fraud control was temporarily drawn into, and then almost immediately detached from, the conventional politics of law and order. Although why this happened is less obvious, the discussion attempts to show how a sharp rise in the prominence of financial regulation as a political issue first coupled commercial fraud control to the major preoccupations of conventional crime policy. The effect of this was to force the government into introducing a series of sweeping reforms that enhanced the capacity of criminal justice to process cases of commercial fraud. Once the importance of financial regulation as a political issue faded, however, commercial fraud control became uncoupled from conventional law and order politics, allowing sustained criticism of long

commercial fraud prosecutions in the news media to create conditions favourable for decriminalisation.

The Criminal Law and Financial Regulation 1972-1980. Crisis, what Crisis?

The most striking aspect of the reforms that transformed commercial fraud control in the eighties was the simple fact of their introduction. Reform to the apparatus of commercial fraud control was uncommon. Comprehensive reform was unprecedented. The creation of the Metropolitan and City Police Fraud Department in 1946 had been the last significant measure to be introduced. Even this, however, was a modest reform, representing little more than the creation of a permanent organisational basis for the investigation of commercial fraud.⁶ Nonetheless, it remained the only meaningful reform for over thirty years. This was not, however, because the system operated satisfactorily. On the contrary, criminal justice intervention was forced to occupy a marginal role in financial regulation. This was, in part, because of chronic understaffing, in part because the police's powers to investigate fraud were spectacularly inadequate and in part because the organisational matrix of commercial fraud control was not only painfully incoherent, but also administered within a pan-organisational culture that was ambivalent about the use of the criminal law against otherwise legitimate businessmen. Once detected, commercial fraud was rarely investigated. Once investigated, it was even less likely to be prosecuted. What is perhaps even more significant, however, is that low rates of investigation and prosecution were even more acute for cases of investment and company fraud involving fraudulent but otherwise legitimate company officers (as opposed to career criminals who used fraud to exploit the commercial form); leading to what, in effect, came close to a permanent amnesty.⁷ The remaining part of the discussion in this section focuses on the bureaucratic, legal and procedural arrangements that underpinned this amnesty and concludes with a short discussion on what it tells us about the politics of commercial fraud control during the seventies.

The Untouchables: Businessmen, the Law and the Organisation of Commercial Fraud Control

Understaffing was generally cited as the main obstacle to routine criminal justice intervention and not without some justification. Major frauds would routinely overwhelm the small number of staff designated to work on commercial fraud.⁸ At the height of the Poulson local government corruption inquiry in the early seventies, for example, a third of the entire Fraud Division of the DPP's Office were working full-time on the case. The police and Department of Trade fared little better. Police fraud departments were widely considered to be chronically understaffed, whilst in the late seventies the Department of Trade had only eight lawyers working on company fraud.⁹ Understaffing was sufficiently acute, in short, to depress routine investigation and prosecution, but understaffing alone did not account for the fact that 'criminals who engage[d] in fraud'¹⁰ were far more vulnerable to prosecution than otherwise legitimate company officers.

This, in many respects, was more a consequence of how the responsibility for commercial fraud investigation was allocated between the Department of Trade and the police – the two organisations primarily responsible for commercial fraud investigation. Although co-operation during ongoing investigations was common, there was a sharp distinction between the type of cases that each organisation typically accepted for investigation. The police tended to focus on fraudulent criminals, leaving the responsibility for investigating fraudulent, but otherwise legitimate, company officers to the Department of Trade.¹¹ The significance of this was that Department of Trade initiated investigations were less common, not always directed to establishing criminal liability, and stood a far smaller chance of producing successful prosecutions. The effect was a systemic bias against the prosecution of fraudulent, but otherwise legitimate, company officers.

On first examination, this might have seemed perverse. The Department of Trade's powers of investigation were more intrusive and, on the face of it, better designed to obtain admissible and incriminating evidence than those available to the police who had few dedicated powers at their disposal.¹² This, however, was largely irrelevant in practice since the Department of Trade's main powers of investigation were either mainly used to enable ongoing police inquiries, as in the case of section 109 of the Companies Act 1967,¹³ or simply not exploited to facilitate criminal prosecution. This failure to realise the full potential of its powers of investigation was especially true of Department of Trade inspections under section 165 of the Companies Act 1948 which, in practice, represented the most significant of the powers used against otherwise legitimate company officers.¹⁴ There were several reasons for this. In the first instance, such inspections were uncommon¹⁵ and, therefore, only occasionally used against otherwise legitimate businessmen. Even when called upon, however, criminal prosecutions rarely followed. One reason for this concerned the power itself which, in a number of important respects, was not designed to unearth incriminating evidence. When Inspectors were appointed under section 165, for example, the fact of their appointment was invariably published, allowing company officers 'to take steps to protect themselves.'¹⁶ Another reason concerned the way in which the power was used. Fraud investigation often found itself subordinated to many other of the non-crime related concerns¹⁷ of Department of Trade inquiries with inspectors 'often reluctant' to inform the Department of their suspicions of fraud.¹⁸ Prompt notice was rarely given.¹⁹ Moreover, even when the Department was informed and a police investigation commenced, the available evidence suggests that the refusal of inspectors to co-operate with the police was common. This was not a characteristic of all investigations or all inspectors. But, even where inspectors lent their full co-operation to the police further delays were not unusual as poor document control made it hard for the police to understand the significance of the evidence provided to them.²⁰ There were even some cases of inspectors failing to take witness statements and returning all the documentation that had been seized to the suspect company, requiring the police to begin an entirely fresh investigation.²¹ Section 165 investigations, in other words, were simply not conducted with a view to the demands of a subsequent criminal prosecution. Long delays were common. Witnesses died, went missing or their memories simply faded, whilst suspects were given ample opportunity to escape the jurisdiction.²² This, of course, did not happen in all cases, but the length of time that usually elapsed

between the offence, criminal investigation and, finally, prosecution meant that once a case was ready to be tried there was always the possibility that the DPP or the courts might decide that the case should not proceed on the basis that to continue would constitute an abuse of process.²³

In short, criminal justice intervention against commercial fraud was extraordinarily undeveloped. Co-ordination between the organisations responsible for detecting and investigating commercial fraud did successfully occur, but this was rare, generally unplanned and inefficient, particularly where the suspects were otherwise legitimate company officers. What is particularly significant, however, was that despite this there seemed little support, and certainly no impetus, for radical reform. This is perhaps best exemplified by the recommendations of the Jardine Working Party, an interdepartmental committee of senior police officers, lawyers from the DPP's office and civil servants involved in commercial regulation at the Department of Trade, which had been commissioned to consider the question of reform to the system of company fraud investigation and prosecution. After considering an impressive body of evidence indicating that commercial fraud control seemed co-ordinated as much to subvert as to facilitate criminal justice intervention against otherwise legitimate company officers, the Committee concluded that the existing arrangements for investigation and prosecution were generally 'good'.²⁴ Their major concern was not with how the law in practice seemed designed to provide companies and, therefore, the company board, with far more protection from criminal investigation than ordinary individuals, but that there were insufficient resources for the state to intervene against criminals who exploited the commercial form through fraud.²⁵ Significantly, this perception persisted despite the fact that far-reaching, fraud-related, financial crises, like that affecting the secondary banking sector,²⁶ persistent scandals at Lloyd's of London and fundamental structural changes to London's financial markets²⁷ had all highlighted the failings of commercial fraud prosecution; namely, the difficulties in mounting prosecutions, the ease with which the system was overwhelmed and the ease with which it would be overwhelmed further as London's financial markets became even more internationally focused and competitive (see below). Prosecution of otherwise legitimate officers was simply not a high enough political or bureaucratic priority to warrant sustained reform in spite of the obvious need for radical change. The simple fact was that, in contrast to criminal justice in general, commercial fraud prosecution had yet to become a political issue.²⁸

There is, therefore, something quite remarkable about what followed over the next decade. By the end of the eighties the system of commercial fraud control had been transformed. An independent committee of inquiry – the Fraud Trials Committee – had been established to consider what changes could be made to almost every aspect of commercial fraud control, two new organisations of commercial fraud prosecution – the Fraud Investigation Group (FIG) and the SFO – had been set up, a number of important evidential and procedural reforms had been introduced to expedite commercial fraud prosecution and an entirely new apparatus of financial regulation with powers of fraud prevention, detection, investigation and prosecution, had been set up. The effect of these reforms was not simply to increase the capacity of criminal justice to prosecute commercial fraud, but, more significantly, to expedite the efficient prosecution of

otherwise legitimate company officers. The important questions, of course, are why and to what extent? What caused the fundamental rethink of financial regulation and commercial fraud control and to what degree did the new system alter the pattern of criminal prosecution? The discussion in the following section aims to address these questions with reference to four distinct, but ultimately related, phenomena. These are the series of well publicised commercial fraud scandals that surfaced with almost unrelenting regularity throughout the eighties, the transformation in the organisation and ownership of some of London's major financial service firms, the process of placing financial regulation on a statutory footing, and the fundamental realignment in British politics that took place during Margaret Thatcher's first and second administrations.

Financial Regulation and Commercial Fraud Control 1981-1992: the Triumph of Criminal Justice Intervention

The Gower Review, Financial Regulation and Commercial Fraud

It is not easy to trace the transformation of commercial fraud control to a single event or point in time. This is, in part, because the reforms that it comprised and changes in political sentiment that drove it did not constitute a unitary programme. There was neither an original design from which the reforms took their shape, nor were they inspired by precisely the same series of events and pressures. What took place was as much accident and coincidence as it was a result of careful planning. A useful point of entry, however, is the well-publicised failure of the investment management firm, Norton Warburg. This set in train a process of reform to financial regulation, culminating in the Financial Services Act 1986, that had a profound, if indirect, effect on the development of commercial fraud control.

Norton Warburg was an established investment management firm that went into voluntary liquidation in February 1981 with losses of client funds totalling £4.5 million. The collapse of the company raised a number of uncomfortable questions about the prevailing apparatus of financial regulation and vigorous lobbying from the Bank of England eventually led to the appointment of an academic, Laurence Gower, to review the machinery of investor protection.²⁹ Gower produced two reports. His first report, published in 1982, found a system which, like commercial fraud control, was extremely undeveloped. Its incidence was fragmented, its scope incomplete and its rules easily circumvented. The major piece of legislation governing the regulation of financial institutions was the Prevention of Fraud Act 1958. This required unit trusts and companies dealing in securities to obtain a licence of authorisation to trade from the Department of Trade. Once licensed, companies were required to observe the Licensed Dealer (Conduct of Business) Rules 1960 which brought the companies concerned under the direct, if imperfect, surveillance of the Department of Trade. Exemption from the relative rigor of statutory regulation (particularly for more powerful financial institutions), however, was widespread;³⁰ leaving large areas of regulation in the hands of unaccountable trade bodies (like the Association of Futures, Brokers and Dealers), many of whom had not even drawn up codes of conduct to guide the business of the companies under their supervision.

Gower recommended an end to the practice of regulatory exemption (or, as he put it, the 'propensity to trust people to behave themselves'³¹) and its replacement with a common system of regulation. His initial proposal involved the creation of a single comprehensive framework in which the Department of Trade would be given broad supervision of the securities industry, whilst allowing self-regulatory organisations to manage the practice of regulation either under the auspices of the Department or a self-standing commission which would devise general rules that could be applied across the whole range of investment businesses. Although the plan was designed to preserve self-regulation, albeit in a form which brought it under overall statutory control, there was unanimous opposition from those sectors of London's financial community that had traditionally enjoyed absolute freedom from statutory regulation and it was the form that this opposition took which proved so significant for commercial fraud control.

Organisations representing financial institutions exempted from formal regulation, and, therefore, critical of Gower's plans (the Council for Securities Industry, the Stock Exchange, the Accepting Houses Committee, the Committee of London Clearing Banks and the City Capital Markets Committee), were faced with an awkward problem; how to defend the existing practice of unsupervised self-regulation without defending the existing system of regulation. Unqualified support for the prevailing system could no longer be credibly defended, not least because serious cases of investment fraud had continued to surface throughout the duration of the initial stage of Gower's Review. Their effect was to steadily undermine confidence in the traditional system of financial regulation, with its almost arbitrary mix of unsupervised self-regulation and direct departmental supervision, raise questions about its efficacy and make calls for the introduction of a new system difficult to resist.³² The only option was to redefine the problem or at least the cause of the scandals. This was achieved with some elegance. The Council for the Securities Industry (which had been established to represent the entire range of interests across London's financial markets) as well as other organisations representing more narrow interests (such as the Accepting Houses Committee, the Committee of London Clearing Banks and the City Capital Markets Committee) argued that the recent spate of investment frauds were not an inevitable consequence of self-regulation, but rather due to the absence of an effective criminal justice deterrent. They, therefore, called for more routine and effective criminal prosecution, principally against those institutions on the margins of London's financial community,³³ whilst arguing for the continued practice of unsupervised self-regulation for those at its centre. As the Council for the Securities Industry put it:

'We do not agree that the present system, which works well, should be replaced by a single comprehensive framework...Unquestionably the greatest weaknesses of the present scheme of regulation lies in the failure to deal effectively with commercial and financial frauds.'³⁴

The call for greater fraud control in this way became part of the much more important undertaking of preserving unsupervised self-regulation – and it was this that had fundamental ramifications for the process of reform to commercial fraud investigation

and prosecution. Before Gower, commercial fraud control, unattached to the politics of law-and-order and without an influential patron either inside or outside government, could quite easily become relegated at the expense of more pressing political concerns. After Gower, however, commercial fraud control had not only become enmeshed in a very explicit way with the interests of the UK's financial community, it had also become inextricably intertwined with the re-regulation of London's financial markets – an issue which, because of imminent changes to the structure and ownership of firms dealing in securities (see below), became absolutely central to the continued success of those markets and, therefore, could be not so easily passed over. By providing a focus for change to the system of commercial fraud control, Gower, in other words, not only raised the profile of the issue, his report also, significantly, had the effect of tying it to one of the central canons of Conservative economic policy – the promotion of London's financial markets.³⁵

One point of qualification is necessary here, not least because, although Gower's impact on the form and incidence of commercial fraud control was immediate, the focus it provided for lobbying from London's financial community did not in itself produce an immediate transformation in Government policy – quite the contrary in fact. This is perhaps best exemplified by the Government's reluctance to fund the Fraud Investigation Group (FIG). *Ad hoc* FIGs had first been piloted in 1981 as a means of putting into practice the Jardine Working Party's recommendation of closer co-operation between the main parties responsible for commercial fraud control.³⁶ Lobbying from London's financial community for more decisive prosecution of commercial fraud led to FIG being placed on a permanent footing in January 1985.³⁷ But despite strong evidence that the FIG concept reduced investigation times and, therefore, expedited the prosecution of otherwise legitimate company officers, they were a casualty of 'reckless under-resourcing'.³⁸ This is not to say that, by binding commercial fraud control to the re-regulation of London's financial markets, the impact of the Gower report on reform to commercial fraud control did not eventually prove decisive, it is simply to argue that its full impact was only realised once the issue of financial regulation became politicised. The next section explores the form that this process of politicisation took and how it informed the introduction of the Criminal Justice Act of 1987 – the major piece of legislation on commercial fraud control in the eighties (or any other decade before or since).

Commercial Fraud and the Politicisation of Financial Regulation

Quite why financial regulation became politicised is too long a question to fully explore in this discussion.³⁹ What is important, however, is the form that the process of politicisation took or, more specifically, how the Labour opposition were able to characterise the Government's proposed reforms to financial regulation in a way that resonated with a range of already well-rehearsed anxieties about Conservative social and economic policy. These arguments were well crafted to undermine Government policy on financial regulation, as well as bringing into question Conservative economic policy. Significantly, not only were they well reported in the news media, but they were also

instrumental in the Government's decision to introduce the Criminal Justice Act of 1987.⁴⁰

Re-regulation of London's financial markets had become unavoidable in the run-up to the set of reforms to the Stock Exchange known as Big Bang. By removing restrictions on entry to the exchange, by doing away with fixed commissions for services and by abolishing the old established division of labour between single-capacity brokers and dealers in shares, Big Bang was designed to enable the Exchange and its member firms to better compete internationally. But because it threatened to produce new, quite powerful, conflicts of interests, as well as allowing foreign firms to take over British member firms of the exchange, Big Bang also rendered obsolete the existing practice of regulation. There were two main reasons for this. The first was that the principles upon which the existing system operated were opaque, whilst the second was that British firms tended to dominate the *ad hoc* committees and networks that interpreted them. A bias in favour of British institutions, in other words, was built into the system. The effect, if the existing system of regulation were retained, would not only have been an unpredictable regulatory environment for foreign institutions, but also a system which (because it was easily open to abuse) could have quite quickly lost the trust of investors.⁴¹ Either way, the capacity of London's financial community to compete internationally would have been damaged.

Big Bang, therefore, ensured that serious consideration was given to translating the recommendations contained in Gower's second report into law. This process substantially raised the political profile of financial regulation, but it was to rise even further once the Government's proposals for regulation began to take shape. The reason for this was simple. Because much of London's financial community was still opposed to direct Government control, the new system of regulation proposed in the White Paper,⁴² *Financial Services in the UK* (and then introduced in the Financial Services Bill), was not radically different from the existing, discredited, system. The White Paper insisted that efficient financial regulation implied the minimum of government intervention. This was reflected in the proposed creation of two overarching practitioner bodies (the Securities and Investment Board, SIB, and the Marketing of Investments Board, MIB) that were given the role of recognising self-regulatory organisations (SROs). These, rather than a government department or statutory commission, as Gower had originally envisaged, would ensure that the SROs could regulate the admission and conduct of their members and make certain that their rules provided an adequate standard of investor protection.⁴³ But, by highlighting the informal nature of financial regulation, the state's commitment to be excluded from direct control over both the business of regulation and the formation of the rules upon which regulation would be based exposed the government to quite serious and sustained criticism.

The scale of the criticism was due to the fact that the Government's continued faith in self-regulation simply seemed to preserve the exclusive status of London's financial community as a private empire outside the law. Self-regulation contrasted quite markedly with other areas of government policy, like that covering industrial disputes, in which discipline under the law had been demanded.⁴⁴ The Labour opposition, in and out of Parliament, made these comparisons with some power, drawing heavily on the fact

that banking and finance had thrived as the rest of the economy (and, therefore, country) had struggled whilst, at one and the same time, emphasising the close relationship between the Conservatives and London's financial centre. The real intelligence of their approach, however, resided in their use of commercial fraud. More specifically, commercial fraud was deployed to link all of these issues together in an all-encompassing narrative that stressed the deep divisions and inequalities of Britain in the eighties, the damaging long-term social repercussions of Conservative economic policy and the Government's insistence on self-regulation. This is best illustrated in a debate in March 1986 in which the Conservatives were urged 'to put aside considerations of political support and personal connection' and introduce a system of regulation which would 'provide an adequate response to the increase in City fraud'. But whereas in earlier debates the Government had been accused of unequally promoting the interests of London's financial community, it was now claimed to be powerless before the City. High unemployment of 3.5 million, real interest rates at record levels and the fact that the UK imported manufactured goods of a value greater than it exported were presented as a direct consequence of the take-over boom in the eighties, London's focus on the short-term and its generation of profits for those working in the financial markets, at the expense of those working in manufacturing. These trends, it was claimed, were attributable to 'the Government's enthusiasm for economic policies which benefit[ed] the City but damage[d] the rest of the economy.'⁴⁵ More significant, perhaps, was that Big Bang not only promised to exaggerate these divisions, but the conflicts of interests it created also threatened to create the risk of dishonest profiteering – a risk that continued scandals at Lloyd's of London and the collapse of the Johnson Matthey Bank had made all the less remote.⁴⁶ Still the Government insisted on self-regulation. But sensitive to criticism of their links with London's financial community⁴⁷ and already fighting political battles on a number of fronts,⁴⁸ the Conservatives required a powerful symbol to dispel the claim that their support for London's financial centre, crystallised in their commitment to self-regulation, extended to tolerance of commercial fraud. An alternative method of expressing restraint and discipline to offset the non-prescriptive nature of the Financial Services Bill was imperative. The obvious answer was criminal justice intervention. The recent publication of the report of the Fraud Trials Committee, therefore, represented an exquisitely fortuitous opportunity.

The Committee had initially been set up in 1983 to explore the continued viability of jury trial for complex fraud cases. Nothing more radical had, originally, been contemplated. Nonetheless, the Committee had formally been given a wide remit to consider how best to reform fraud investigation, prosecution and trial and it used this to full effect once the full extent of fraud and the failures of the existing system of commercial fraud control became apparent to its members. A number of radical proposals – including the establishment of a 'single unified organisation responsible for all the functions of detection, investigation and prosecution' – were recommended.⁴⁹ And, although the Government's 'cynical determination to limit expenditure'⁵⁰ on FIG suggests that, under normal circumstances, it would have been more selective in its implementation of the Committee's recommendations, in the peculiar, polarised politics of the mid eighties, the Government used every opportunity to publicise the fact that it was considering the Committee's recommendation to combine the resources of the police, the DPP, the

companies inspectorate of the Department of Trade and the revenue's department into one unit.⁵¹

The Criminal Justice Act of 1987, which translated many of the Committee's recommendations into law, did not, in the event, establish a unified body of fraud detection, investigation and prosecution. Government ministers had originally expressed a preference for the idea, but it was soon jettisoned when it became clear that the time-consuming constitutional and legislative amendments to the position of the police and their powers that this would involve could not be realised prior to the crucial 1987 election.⁵² Instead, a compromise, the SFO, was conceived. This was a wholly new and independent investigative and prosecutorial organisation with special powers of investigation, made up of accountants, lawyers and support staff. Its powers – so-called section 2 powers after the section of the Act under which they were granted – enabled SFO lawyers and accountants, but not police seconded to the organisation, to require anyone with relevant information, including suspects, to answer questions and provide information relevant to an ongoing investigation. An application to a court of law, even if the source of information were a bank, was no longer necessary. Thus, although the SFO fell short of what the Fraud Trials Committee had recommended, it was nevertheless a highly distinctive organisation, equipped with powers of criminal investigation which denied suspects their right to silence, and, therefore, conveyed a potent mixture of censure, condemnation and reprobation. The effect, at least in part, was to vindicate the government's otherwise permissive approach to financial regulation, by showing that, ultimately, London's financial centre would not escape the demands of a strict and uncompromising legal regime. More significantly, it served to articulate a distinctive message about the distribution and nature of power within society; a testament to the primacy of the state over finance capital and a powerful declaration of its resolution to impose its authority through the law without discrimination.

The Creation of the Serious Fraud Office

The SFO was not the only major reform introduced, but it was the most prominent of the series of changes brought in under the Criminal Justice Acts of 1987 and 1988. Their collective effect was to transform commercial fraud control. Among other measures, section 15 of the 1987 Act abolished the legal restrictions placed on the offence of conspiracy to defraud and, therefore, allowed the prosecution to prosecute with an offence that reflected the gravity of the crime. Other measures, such as sections 23 and 24 of the 1988 Act, which modified the restrictions on documentary hearsay evidence, had the effect of expediting prosecutions. The same was true of the transfer for trial mechanism, (a process which allows the prosecution to move the case to the Crown Court with a reduced right of objection by the defence and no scrutiny by the magistrates' courts) and the preparatory hearing concept (which was aimed at providing a pre-trial forum in which the main issues could be isolated and the issue of how best to present the case to the jury with limited interruption could be determined). Both were aimed at reducing the time taken to get cases to court as well as (in the case of the preparatory hearing at least) the trials themselves and, in attempting to increase the efficiency of the

process, typified the immediate instrumental aim of all the reforms that had been introduced.

The establishment of the SFO, however, represented the most radical of all the measures, not least because it involved a large increase in the resources devoted to commercial fraud control. This is best illustrated if we compare the SFO's budget and resourcing with that of the FIG. In 1986 the FIG had a total of 60 staff, of which only 18 were professionals, with a budget of £1.5 million. This was well under half of the £4 million the SFO was estimated to require in the explanatory and financial memorandum to the Criminal Justice Bill which was considered sufficient to fund 80 staff. By the end of the financial year 1990-1991, the SFO employed 103 civil servants and had a budget of over £13.5 million.⁵³ The impact on criminal justice intervention, although difficult to calculate precisely, was significant. The SFO led to an increase in prosecutions generally and an upsurge in cases involving otherwise legitimate company executives.⁵⁴ Yet although the impact of the SFO and the attendant changes to the law of evidence and procedure contained in the Criminal Justice Act 1987 was unprecedented, it did not represent the fundamental reconfiguration in the scope of criminal based financial regulation that was sometimes suggested in the news media. On the contrary, whilst, in the first seven years of its operation, the SFO had a very real effect on increasing the throughput of prosecutions involving otherwise legitimate company officers, an average of only sixteen cases *per annum* involved organisational frauds committed through otherwise legitimate companies, fewer still, an average of only four cases *per annum*, involved chief executive officers working for financial institutions situated in London's financial markets or public limited companies.⁵⁵ The fact that most of the SFO's cases involved companies that had defrauded banks and institutional investors suggested that the SFO was less the police force of the City, as had been represented during the passage of the 1987 Act through Parliament, and more a police force for the City.⁵⁶

Financial Regulation 1992-2002: the Relegation of Criminal Justice Intervention

Guinness, Blue Arrow and Decriminalisation

Despite the disjunction between how the SFO was represented and how it operated, the process of criminalisation was nonetheless quite spectacular – at least relative to the previous history of commercial fraud control. Even more striking, however, was that it was over almost as soon as it had begun. To some extent the process of criminalisation had first begun to unravel the moment the judge passed sentence against the Blue Arrow defendants. Their suspended sentences, justified on the basis that they 'had suffered enough', was a very public declaration that (at least according to the trial judge) the prosecutions had been a mistake. This derived additional support from Mr Justice Henry who, after the collapse of the second Guinness trial, urged that 'some other way' of resolving complex cases of fraud be found. Six months later, on 25th May 1992, the Court of Appeal provided conclusive confirmation of the judiciary's scepticism of criminal justice expansionism, or at least the form it was taking, when it quashed the convictions of the four remaining Blue Arrow defendants. The criticism of the SFO that followed was considerable, although not entirely accurate. One of the main arguments contained in the

coverage by the financial press of the Blue Arrow trial was that, at a reported cost £35 million, the trial had been an inexcusable waste of public money. The figure used, however, was based on adding the defendants' own calculation of their legal fees to court and SFO expenditure, rather than the overall cost to the public purse. This was just over £14 million once the appeal was concluded and the defendants awarded their costs.⁵⁷

Both the source and the size of the figure, however, were irrelevant. Political sentiment had turned against criminal justice as a means of regulating finance and banking as it became apparent to the government that criminal prosecution was simply an expensive means of amplifying dishonesty in British companies and apparent to the Labour opposition that it would have to embrace, rather than question, the economics of neo-liberalism if it were to win the support of the Murdoch press. Although, the actual operation of the SFO had brought about the conditions of its demise, it was the shift in the politics of the Labour front-bench which ultimately allowed decriminalisation to take effect without event.

The process of decriminalisation was, for this latter reason, less of a flamboyant affair than the process of criminalisation that had preceded it. Among other things, the SFO agreed a memorandum of understanding with the SIB concerning the nature of the interface between criminal justice intervention and regulation that was aimed at militating against the future prosecution of cases similar to Blue Arrow and Guinness in which still solvent corporations were able to provide compensation to defrauded investors. The prosecution culture of the SFO also became more conservative, ensuring that cases like Gooda Walker (which had emerged out of the financial problems at Lloyd's), for instance, were discontinued prior to a full investigation when, in the past, there was a greater likelihood that further action would have been taken.⁵⁸ Greater caution, however, was insufficient to curb criticism of the SFO which continued in its failure to secure convictions against the main defendants in its more publicised cases. The acquittal of George Walker, former chair and chief executive of Brent Walker, the non-custodial sentence of Roger Levitt, former chief executive of the Levitt Group, and the acquittal of the Maxwell brothers, served to bring its very existence into question.

The Infrastructure of Commercial Fraud Control

Despite two reviews exploring whether it still warranted its status as an organisation independent from the Crown Prosecution Service (CPS), however, the SFO survived, albeit in a modified form.⁵⁹ In fact, outwardly at least, the SFO seemed to positively profit from the review process. One recommendation had resulted in the SFO's enlargement. Whereas in the past it had been expected to have fifty active cases at any one point in time, it was now expected to process a hundred. More staff were recruited. But, in truth, this was not an endorsement of how the SFO had been run. On the contrary, the reform merely constituted a reverse take-over by the fraud divisions of the CPS, in which the philosophy of the SFO - an ambitious, almost creative, prosecuting organisation - was extinguished. The SFO now processes more cases with far more staff, but its budget has remained more or less constant. The SFO, in one sense, has survived in name only, although, of course, its structure has remained in tact. Beyond the SFO,

meanwhile, the infrastructure of commercial fraud control has gradually crumbled. The Fraud Investigation Group was first organised into the fraud divisions of the CPS, before the idea of dedicated fraud Crown Prosecutors was abolished outright. Fraud officers are left to instruct CPS lawyers without the specialist expertise usually required to give a fully informed decision. A similar process of attrition has reduced the number of police officers specialising in fraud. Current estimates suggest that the number of fraud officers has halved over the last ten years.⁶⁰ Moreover, the formal establishment of the Financial Services Authority in December 2001, when the Financial Markets and Services Act came into effect, does not seem to have influenced the balance between criminal justice intervention and administrative financial regulation. On the contrary, the available evidence suggests that the organisation of the Financial Services Authority is structured to defeat referrals of commercial fraud to the authorities in much the same way as the SIB had been.⁶¹

Conclusion

Just why large areas of commercial fraud - a crime governed by the conventional criminal law but committed by unconventional criminals - should be exempted from the relentless advance of penal control raises all the big political questions that are often absent from criminological thinking - namely, who rules, in whose interests, to what ends and how. The creeping period of criminalisation between 1981 and 1992, however, was equally significant. It meant that commercial fraud control escaped the 'deregulatory fetish'⁶² that characterised other areas of corporate regulation in the eighties, raising a range of important questions concerning whether the principles that govern other areas of corporate regulation are of universal application. Commercial fraud control became drawn into the same politics of law and order that drives much of conventional criminal justice policy, but these politics have not driven commercial fraud control in perpetuity. In fact, it was once the politics of law-and-order began to assume their most virulent form in the early nineties, that commercial fraud prosecution finally became detached from the same politics of law and order that drives much of contemporary criminal justice policy. Commercial fraud had once been a focus for a whole range of anxieties and criticisms - used to symbolise the inherent injustice of globalised, under-regulated financial markets. But once parliamentary politics and industrial relations in the UK took on a less polarised form, and these associations no longer applied, the control of commercial fraud (through the framework of criminal justice at least) lost its political relevance. The politics of law and order, in other words, may influence commercial fraud policy, but government policy in this area is not reducible to it. Instead commercial fraud prosecution has to be understood in terms of more general changes to the apparatus of financial regulation and shifts in thinking among politicians, criminal justice professionals and regulators about what form of regulation is best for the financial service industry.

¹ D. Owen, and R. Hughes, 'Fraud law faces urgent reform in England', *The Financial Times*, 27th February 1992.

² R. Harris, 'The Cost of Criminal Justice', *Home Office Research Findings No. 103*, Home Office Research, Development and Statistics Directorate, 1999.

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- ³ See, for example, M. Levi, 'The Investigation, Prosecution and Trial of Serious Fraud', *The Royal Commission on Criminal Justice*, Research Study No.14, London, 1993, p.9.
- ⁴ K. Newman, *Written Evidence of the Commissioner of Police of The Metropolis to the Fraud Trials Committee*, unpublished, 1985.
- ⁵ Sir Thomas Hetherington, DPP, quoted in W. Ellis, 'Police Tackle Growing Problem of Fraud', *The Guardian*, 29 March 1985.
- ⁶ Home Office, 'Home Office Circular No. 16/1985 to Chief Officers of Police concerning the Investigation of Fraud', unpublished.
- ⁷ Fooks, *ibid*, 1997.
- ⁸ Personal communication with J. Wood, first Director of the SFO, 8 September 1994. On funding generally in the seventies see M. Levi, *Regulating Fraud*, Tavistock, 1987.
- ⁹ Jardine Committee, *Report of the Working Party on the Investigation and Prosecution of Company Fraud*, unpublished, 1979, pp.8 and 13-14. See also B. Rider and E. Hew, 'The Regulation of Corporation and Securities Laws in Britain – the Beginning of the Real Debate', *Malaya Law Review*, 1977, p.151.
- ¹⁰ This was a term used by the Jardine Committee.
- ¹¹ Jardine Committee, *ibid*, 1979, pp.7-8.
- ¹² Director of Public Prosecutions, *Director of Public Prosecution's Answers to Questions put by the Fraud Trials Committee*, unpublished, 1985. Jardine Committee, *ibid*, 1979.
- ¹³ Director of Public Prosecutions, *Director of Public Prosecution's Written Evidence to the Fraud Trials Committee*, unpublished, 1984. But see Rider and Hew, *ibid*, 1977, p.153.
- ¹⁴ Fooks, *ibid*, 1997.
- ¹⁵ B. Rider and E. Hew, *ibid*, 1977, p.146. By 1980 only one new investigation was approved. Department of Trade, *Companies in 1972: the Department of Trade Annual Report 1973-Companies in 1980: Department of Trade Annual Report 1981*, Department of Trade, 1973-1981.
- ¹⁶ Jardine Committee, *ibid*, 1979.
- ¹⁷ See further Hadden, T. *Company Law and Capitalism*, 2nd edn., Wiedenfield and Nicholson, 1977.
- ¹⁸ Director of Public Prosecutions, *ibid*, 1984. Jardine Working Party, *ibid*, 1979.
- ¹⁹ DPP, *DPP's Oral Evidence to the Fraud Trials Committee*, unpublished, 1985.
- ²⁰ Jardine Committee, *ibid*, 1979.
- ²¹ Rider and Hew, *ibid*, 1977, p.153.
- ²² L. Leigh, *The Control of Commercial Fraud*, Heineman, 1982.
- ²³ For a discussion of this see Fooks, *ibid*, 1997.
- ²⁴ Jardine Committee, *ibid*, 1979, pp.2-3.
- ²⁵ Jardine Committee, *ibid*, 1979, pp.43.
- ²⁶ See M. Reid, *The Secondary Banking Crisis 1973-1975*, Macmillan, 1982.
- ²⁷ M. Clarke, *Regulating the City*, Open University Press, 1987.
- ²⁸ Fooks, *ibid*, 1997.
- ²⁹ A. Hilton, *City within a State*, Tauris, 1987, p.46. L. Gower, *Review of Investor Protection. A Discussion Document*, HMSO, 1982, p.2. L. Gower, *Review of Investor Protection. Report: Part I*, Cmnd. 9125, HMSO, 1984, para.1.10.
- ³⁰ In 1981 there were over 400 exempted dealers. Black, *ibid*, 1997, p.47.
- ³¹ Gower, *ibid*, 1982, para.6.84.
- ³² Gower, *ibid*, 1984, para.1.10.
- ³³ DPP, *ibid*, 1984.
- ³⁴ The response of the CSI to Gower's Discussion Document quoted in *The Economist*, vol.238, no.7244, 1982, p.73.
- ³⁵ J. Coakley and L. Harris, 'Financial Globalisation and Deregulation', in J. Michie (ed.) *The Economic Legacy 1979-1982*, Academic Press, 1992.
- ³⁶ They were designed to provide a framework in which the Department of Trade, police and the DPP's Office could consult at the outset of an investigation. By enhancing co-operation, investigation times were estimated to be reduced by a third. Home Office, *Written Evidence to the Fraud Trials Committee*, unpublished, 1984. Fooks, *ibid*, 1997.
- ³⁷ DPP, *ibid*, 1984.
- ³⁸ This was an observation made by Doiran Williams, a one time Controller of FIG. When the FIG concept was finally placed on a permanent footing in 1985 no new staff were recruited to the organisation despite a

near 50 per cent increase in cases. The same was true of 1986, leaving a total of 60 staff, of which only 18 were professionals, to process nearly 600 cases (also see below in the main text). D. Williams, 'The Evolving Legal Procedures – Prosecution and the DPP', *Fraud '87: The Proceedings of the Conference given by the Institute of Chartered Accountants in England and Wales and the Law Society*, 28 January 1987, Institute of Chartered Accountants in England and Wales, 1987. M. Levi, *ibid.*, 1987, p.177.

³⁹ See M. Moran, *The Politics of the Financial Services Revolution: The UK, US and Japan*, Macmillan, 1991. M. Reid, *The Revolution in Britain's Financial Services Sector*, Macmillan, 1988.

⁴⁰ J. Wood, *ibid.*, 8 September 1994.

⁴¹ Hilton, *ibid.*, 1987. Black, *ibid.*, 1997.

⁴² Department of Trade and Industry, *Financial Services in the UK – A New Framework for Investor Protection*, Cmnd. 9432, HMSO, 1995.

⁴³ Black, *ibid.*, 1997, pp.52-61.

⁴⁴ B. Fine and R. Miller, *Policing the Miners' Strike*, Cobden, 1985.

⁴⁵ R. Hattersley, *Hansard* (HC), vol.89, col.941-944, 13 January 1986.

⁴⁶ Clarke, *ibid.*, 1987. Black, *ibid.*, 1997.

⁴⁷ See M. Button, *Financial Regulation*, Bow Group, 1986.

⁴⁸ A. Gamble, *The Free Economy and the Strong State*, 2nd edition, Macmillan, 1994.

⁴⁹ Fraud Trials Committee, *ibid.*, 1986, p.26. *Hansard* (HC), vol. 48, Written Answers, cols.83-84, 8 November 1983; *Hansard* (HL), vol.444, Written Answers, col.790. J. Knox, *Paper Presented to the Chartered Institute of Bankers*, 11 Lombard Street, 1st October 1992. Fraud Trials Committee, *Fraud Trials Committee Report*, HMSO, 1986, p.5. Fooks, *ibid.*, 1997.

⁵⁰ Williams, *ibid.*, 1987.

⁵¹ See, for example, N. MacGregor, *Hansard* (HC), 1986, vol.89, col.949, 13 January 1986.

⁵² Fooks, *ibid.*, 1997.

⁵³ Williams, *ibid.*, 1987. The full Parliamentary Grant for the SFO's first year was just over £8.6million. SFO, *Annual Report 1988-1989*, HMSO, 1989. SFO, *Annual Report 1989-1990*, HMSO, 1990.

⁵⁴ Fooks, *ibid.*, 1997.

⁵⁵ G. Fooks, *The Serious Fraud Office: a Police Force of the City or a Police Force for the City*, paper presented to the British Criminology Conference, Liverpool John Moores University, 1999.

⁵⁶ Fooks, *ibid.*, 1999.

⁵⁷ Fooks, *ibid.*, 1997.

⁵⁸ Fooks, *ibid.*, 1997.

⁵⁹ S. Davie, *SFO and CPS Fraud Division (Merits and Feasibility of Merger): Report to the Attorney General*, unpublished, 1995.

⁶⁰ N. Hopkins, 'Detective attacks lack of fraud officers', *The Guardian*, 2 October 2002.

⁶¹ G. Fooks, 'In the Valley of the Blind the One-Eyed Man is King: Corporate Crime and the Myopia of Financial Regulation', in S. Tombs and D. Whyte (eds) *Unmasking the Crimes of the Powerful*, Peter Lang, 2003.

⁶² S. Tombs, 1996, 'Injury, Death, and the Deregulation Fetish: The Politics of Occupational Safety Regulation in U.K. Manufacturing Industries', *International Journal of Health Services*, 26(2): 309-329.

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